DOW THEORY LETTERS INC.

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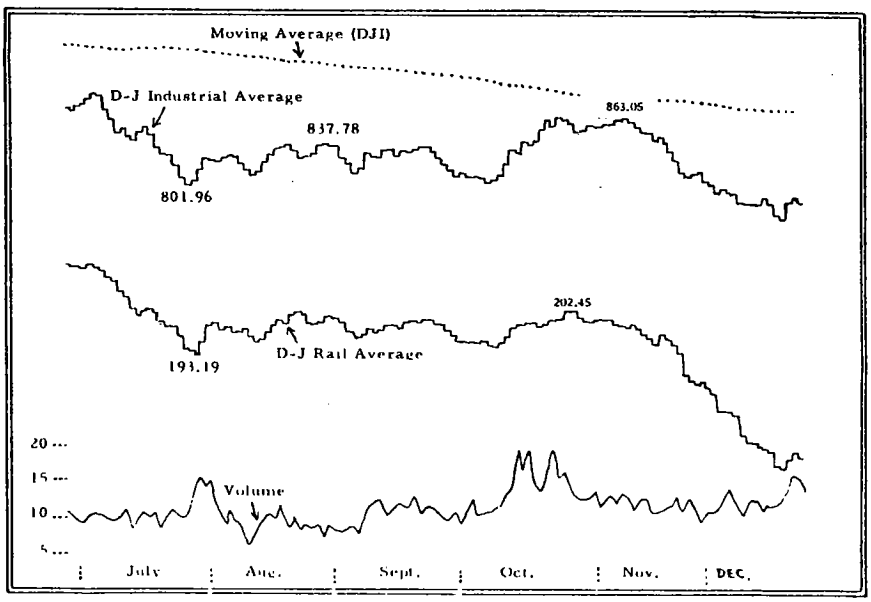
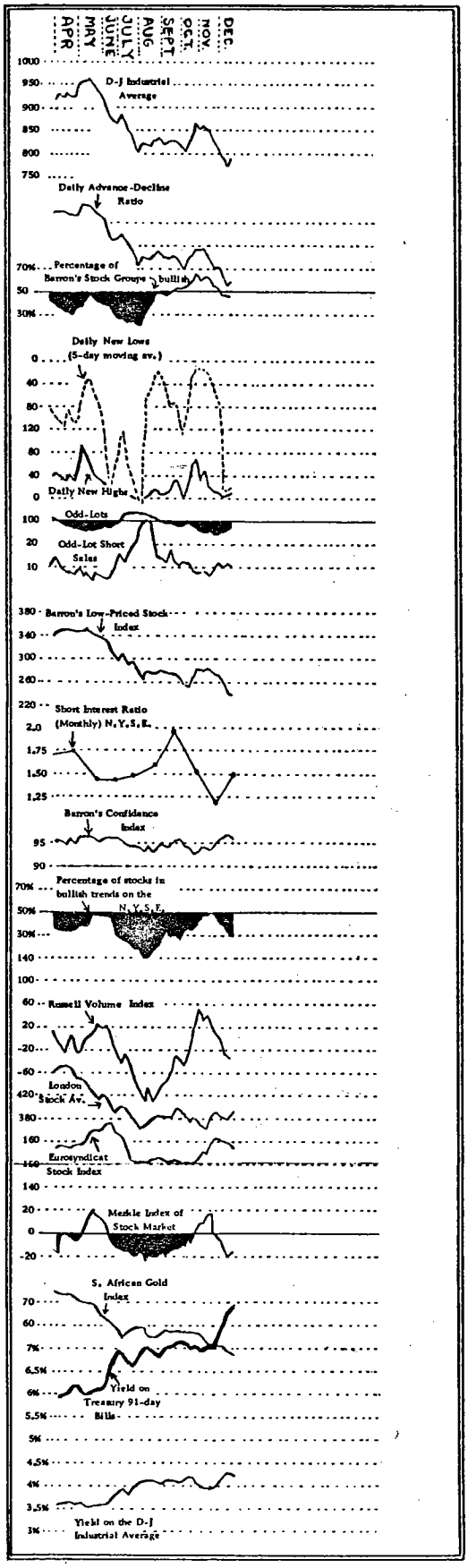
THE MARKET: There is little question about it, 1969 was the year when the primary bear market took hold again (following a two-year upward correction from the October, 1966 lows to the December, 1968 highs). There has seldom been a year like 1969 for sheer breadth of losses. At the December lows the Industrial Average lost around 200 points or about 20% of its value, the Rail Average lost around 110 points or over one-third of its value, the Utility Average lost around 34 points or over 20% of its value. The bond sector, instead of (classically) rallying in the face of a weak stock market, literally fell apart. Municipals were down over 25%, Treasury bonds were down 12% to 15%, convertible bonds in many cases sustained losses of up to 40%, the D-J 40 Bond Average was down almost 10%. As one trader on the New York Stock Exchange put it, "The only positive thing I can think of is that 1969 will be over soon."

There had not been a rally worthy of the name (even a one-day rally) for two months. On December 18 a rally finally arrived with Industrials closing up 13.86 and Rails lagging (in percentage of rise) but still up 2.01. The rally was followed by upside action on Friday, December 19, with Industrials tacking on another 6 points. With the seasonal factors leaning towards the upside, and with the advance-decline ratio having lost a whopping 6.5 points in an almost straightline dive since mid-November, a rally would now seem in order. It should be noted, however, that this turnaround has come almost totally without confirmation from the odd-lot short sellers, and I would say that this decline, although vicious, has brought in fewer odd-lot short sales than any of its type that I have ever seen. I consider this a very negative factor for the future.

The excuse for the turnaround was the December 18 guarded statement by Arthur Burns (soon to be Chairman of the Federal Reserve Board) to the effect that the Government would like very much to avoid a recession. This is





supposed to represent an easier line than the one which present Chairman Martin might have followed. As far as I am concerned, the die is already cast, it has been for a long time. Even as Burns spoke, the latest Labor Department figures showed fat increases in wholesale prices for November, and it was obvious that inflation was as much with us now as it was six months or a year ago.

Burns or anyone else can hope for a "painless way" to end the worst inflation in decades, and no doubt there will be many who want to believe that it can happen. Hopes and wishes may produce rallies, even violent rallies, but they don't reverse the primary trend. The primary trend is cosmic, it is guided only by the long-term fundamentals of the situation. The fundamentals will not change with the ascendency of Mr. Burns to the Chairmanship of the Fed. The fundamentals call for an ultimate liquidation of mountains of debt and a halt to deficit spending, both of which are producing the current vicious inflation and the highest interest rates in history. By the same token, liquidation of debt and a pull-back in spending in an economy which is running at white heat must produce economic pain. There's no way around that anymore than there's a way around the proposition that two and two equals four. If there was a way out, the stock market would not have caved in during 1969. And it is discouraging to note that all the market stress of 1969 has so far not put a dent in the upward pressure of inflation (although it is beginning to affect spending).

BIG PICTURE: The accompanying chart shows the path of the D-J Industrial and Rail Average from 1962 to date. Note that the long series of non-confirmations between Industrials and Rails (a series which I drew attention to repeatedly, during 1968) finally seemed in the process of being resolved. The non-confirmation series began in 1967 when Rails pushed to a new high of 274.49, three points above the 1966 peak. Industrials failed by 52 points to confirm. A decline carried into 1968, followed by a new rally which took Rails to a second all-time high of 279.48 in December, 1968. Again Industrials failed to confirm, this time by a mere 10 points.

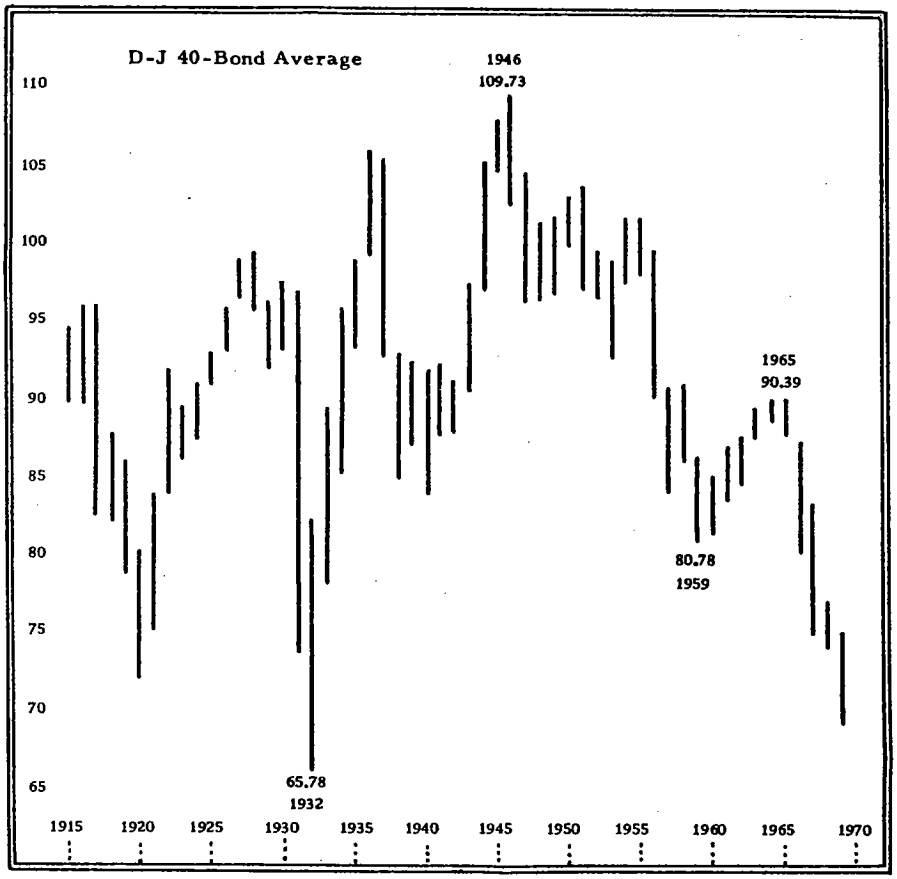
The second major non-confirmation (December, 1968) proved too much for the market. I wrote at the time that if the Averages refuse persistently to confirm in one direction, the odds heavily favor an eventual confirmation in the opposite direction. The opposite direction was down.

The downward movement began on February 8, 1969. It continued with but one important interruption (i.e., August-November) for the greater part of the year. On December 2, 1969, the Rail Average plunged under its 1966 bear market low of 184.34. This constituted one-half of a primary bearish signal or one half a re-confirmation of the primary bear trend. It then remained a question of whether Industrials would confirm by penetrating their own 1966 low of 744.32.

On December 3, 1969, the Industrail Average broke the much-vaunted 800 level. With hardly a day's respite, the senior Average continued down. On December 16 the Industrial Average plunged below its 1967 low of 786.41, and in so doing erased the last level of any importance this side of the 1966 low of 744.32.

I believe that it is only a matter of time before the 1966 low is violated by the Industrial Average. We may have minor or even an important rally prior to a penetration of the 1966 low, but if I had to guess I would guess that the 1966 low for Industrials will be ruptured sometime during the first quarter of 1970. I base this

somewhat on the long delay since the last confirmed bear market lows of October 7, 1966. It has been three years and two months since those lows. That is an extraordinarily long period for a continuing primary bear market to resist making new lows. With Rails, Utilities and Bonds leading the way, I do not think the Industrails can be too far behind.



BONDS: I've been writing about bonds and the money market for many years now. When I first started drawing attention to the crumbling bond market many of my subscribers wrote to ask me why I bothered with the bond market when nobody was interested in bonds and, moreover, they hadn't the faintest idea of what the debt market was all about. In Letter after Letter I answered that the bond market was tremendously important, and that a knowledge of what was fated to happen to the bond market would prove critical both to the stock market and to all investors.

Now, everybody is talking about the bond market, but very few publications still seem to have any concept of what it is all about. I have included a rather rare chart showing the entire history of the broad D-J 40-Bond Average, from 1915 to date. The chart traces the annual high and low for the 40-Bond Average for those past 55 years.

Note that the major bull and bear markets in bonds are clearly delineated, also that the bull and bear markets in bonds tend to be extended. We have a bear market in bonds ending in 1920, a bull market lasting to 1928, a violent bear market into 1932, at which the 40-Bonds established a record depression low of 65.78. A giant bull market in bonds took the 40-Bond Average to an all-time high of 109.75 on February 8, 1946. From 1946 to the present bonds have been in the greatest bear market on record.

From the 109.75 peak of 1946, the 40-Bonds broke to a low of 80.78 in 1956. A correction returned the 40-Bonds to 90.39 in 1965. From 1965 on, the bond market has again been caught in the grip of the bear. Note that the low for the 40-Bonds during the "credit-squeeze" of 1966 was 79.98. That was considered a disaster. The 1966 disaster, however, was only a prelude!

In early December, 1969, the 40-Bond Average broke 70 for the first time since 1932 (remember, in 1932 the very solvency of the nation was in question). On December 12 the 40-Bond Average broke the 69 level, leaving the Average less than 4 points away from the "national insolvency" level of June, 1932.

Almost daily we are offered predictions from leading experts to the effect that the bond market is at or near the low, or that "the peak in interest rates is just around the corner." Frankly, I wouldn't give a plug nickel for the predictions. I believe what I see, and each week brings new highs in interest rates in one or more segments of the bond market (with, of course, new lows in the actual bonds). If it's not municipals collapsing, it's the Moody's Aaa list; if not Moody's it's Barron's 10-Highest Grade or the D-J Bonds or the Treasury list, or the BA list. It appears to me that the bond market is on the way to total demoralization, and by this I mean it is on the way to the point where fresh issues simply cannot or will not be absorbed.

If I am correct in that, the prediction also has a direct bearing on the stock market. I do not know of a time in history where a demoralized bond market did not have a demoralizing effect on the stock market. Today, when new common stock issues

and glamor issues still sell with comparative ease in the face of a virtual collapse in bonds, I can state that there is something drastically wrong. Either stocks are going to join bonds into chaos— or bonds are seeing their lows. I suggest that the former may be the case.

LIQUIDITY CRISIS: In the last Letter I showed how dangerous the current situation is from the liquidity standpoint, and the chart on page 3 illustrated the fact that the banking system is skating on very thin ice (substitute "margin" for ice).

The latest issue of the Cleveland Trust Co.'s authoritative Business report begins like this: "Another month of the same desultory results that so far have followed the Administration's anti-inflation program is likely to be very hard on the financial markets. Even though unemployment has increased for two months, the big surge in durable goods in September leaves the strong impression that public economic policy has still not dealt firmly enough with the inflationary boom that continues."

Ah yes, inflation continues stronger than ever, and the credit structure of the nation gets increasingly weaker. My friend from Gotham, economist Eliot Janeway puts the matter a little stronger than the Cleveland Trust. In his latest report Janeway talks about major trouble breathing down our necks. Following are a few salient excerpts from the December 10 Janeway Service. "The real danger is that zero hour is here for the insolvency which the quacks in command have engineered as the cure for the inflation they are aggravating." ....."The question is no longer whether maturities are going to be missed. The question is now where the first maturities big enough to make front-page news will be missed. The betting varies all the way from sovereign states to insurance companies inside their jurisdiction."

A few more: "....Demoralization is well on its way from being merely a frequently used figure of speech describing the atmosphere of the bond market into becoming an actual condition. Moreover, demoralization will soon become as meaningful a description of the stock market as it has been of the bond market." Finally, "1969 is going down into history as the year in which the system was able to improvise reserve sources of liquidity to build it up to a bigger bust. 1970 is coming up as the year in which the system is fresh out of new sources of liquidity that would be needed to continue accomodating the demand that is continuing to pile up."

I'll admit it's a bit hard to follow those sentences from Mr. Janeway, but I'll add a bit of my own. On top of the possibility of a liquidity crisis, or should we say added to it, I see a huge squeeze coming on corporate profits. I believe the squeeze is coming from a number of directions. Although I have never been fired up on polls regarding what the consumer is going to do, I find it interesting that recent polls are finding the consumer in an increasingly "no buy" mood. I include the little clip from the December 12 Wall Street Journal regarding the University of Michigan poll. If Michigan is anywhere near accurate, sales are going to topple as they did in 1957, as far as the American public is concerned. Now sales dropping off in the face of a fundamentally healthy economy will hit corporate profits. For instance, the average drop in corporate profits for the four post-World War II recession was (this may shock you) 30%. And during those recessions, corporations were relatively flushed with cash (i.e., they were liquid). But that is hardly the case today. When you are up to your neck in debt and your sales (and profits) decline, your earnings cave in. And that is where corporations could be next year.

Consumers' Outlook Slid for Third Quarter In Row, Survey Finds

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University of Michigan Puts Attitudes This Fall Close to Low Before '57-'58 Recession

By a WALL STREET JOURNAL *Staff Reporter*

ANN ARBOR, Mich. — Consumer attitudes deteriorated for the third quarter in a row and are currently near the low point reached before the 1957-58 recession, a University of Michigan consumer survey indicates.

Economists at the university's Survey Research Center concluded that, barring good news in such areas as the fight against inflation, unemployment, the Vietnam war or tax

Furthermore, with a monetary squeeze on, corporations are finding it increasingly hard to "pass on" rising costs. Those rising costs include boosts in the prices of materials, explosions in the cost of labor and a general decline in productivity. In other words, corporations with low liquidity are going to be in a bind when profits melt away, and those profits are now being subject to about every squeeze imaginable.

Finally, I want to mention the greatest unknown of all, mass psychology. This is the variable which can throw all the figuring and all the economic series into a cocked hat. If confidence, both on the part of business and the consumer, starts crumbling, a snowball effect can begin. Such snowball effects are common enough in bear markets, and this is the factor which can turn optimism into a boom during a bull market and trouble into disaster during a bear market.

I submit that literally none of the leading economists today are taking mass psychology into account in their prediction for 1970 and thereafter. No one is allowing for the collapse of confidence which almost always makes its appearance during a major bear market. But this is the thing which worries me most. It is the "hidden ingredient" which could turn a 1970 recession into a 1971 depression and take the Dow down to 350 or 400 instead of a more "reasonable" 650 or 700.

Major bull markets and bear markets have a habit of producing the unexpected. They have a way of making people say, "Gad, I never thought it would go this far!" Will we hear those time-honored words during 1970 or '71? I think we will.

TOLL SO FAR: The toll of this primary bear market is beginning to build up, and this even before the 1966 lows have been broken. A glance at any comprehensive chart book on the Amex (for instance, the Quote Digest weekly booklet) will show a breathtaking mass of collapses, many of which have wiped out 50 to 80% of individual stock values.

Personally, I am more interested in the path of the giants, for these are the stocks which reap the massive profits and sales, and these are the issues which employ millions of workers. They are the "backbone of the economy" stocks, and they make their home on the New York Stock Exchange. At present, American Can has dropped to its lowest level since 1952. Allied Chemical is at a 19-year low. Anaconda is down to its 1965 level, but it is also far below the price it could have been bought in 1956. Bethelehm Steel is within a point of its 1955 level. DuPont in the 104 area or its level of 1955. General Electric has slid to its 1963 price area. General Motors is within a point of its 1963 price. International Harvester is at the 1963 zone, and actually below its 1959 top.

The big oils have suddenly caved in with Standard of California down to its 1961 price and Standard of Jersey hovering just above its 1966 low. Texaco, which was a powerhouse from 1949 to 1964, has broken its 1966 low and is back in the 1963 area. Union Carbide, the nation's second biggest chemical company after DuPont, has collapsed to its 1954 level. United Aircraft, down from the 1967 high of 111, is (at 40) at a five-year low.

It should be remembered that these are the type of stocks which are the mainstay of many a trust and college endowment and bank portfolio. They are owned in huge quantities by conservative institutions, and their recent staggering declines must be turning many a portfolio manager prematurely gray.

But how about the mutual funds themselves? This is the area where the public has placed its money in unbelievable quantities. This is the area in which the public has invested remarkable "faith." The smaller funds in general have not kept up with the Dow, which so far in 1969 has lost 17% of its value. A number of the smaller funds have done considerably worse than the Dow. For instance, the Ling fund is down 47% this year and the Hubschman Fund is down the same. Adding commissions, a buyer in either of these funds has lost half his money on paper. That's enough to chill anyone's bones.

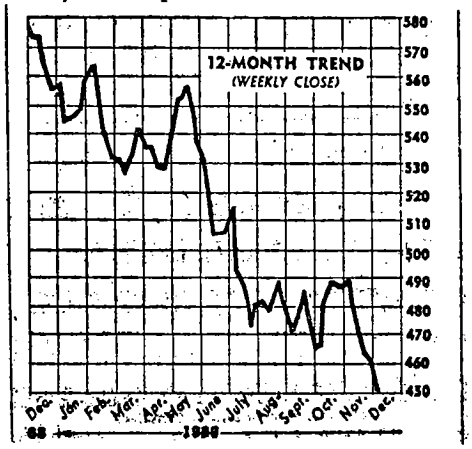
But again, it's the big funds with assets of over $100 million which interest me. I am including a rundown (put out by Arthur Lipper on Nov. 26) which may provide an idea of what has happened in giant-ville. At the best end of the picture, only five big funds were able to show a plus, the greatest being a plus 3.71% for National Investors. At the costly end of the picture, the losses run anywhere from 22.2% for Axe Houghton B during 1969 to a full one-third for the Putnum Fund during the same period.

To put it another way, the performance of the funds during 1969 has been disheartening to the little investor. In almost all cases, it is a matter of how much he has lost. The critical factor is whether the little investor starts losing confidence in the funds. If and when that happens, I think we are going to witness a stampede to redemptions. Redemptions are going to mean steady pressure on the stock market as the funds unload stocks to retrieve cash. That type of situation could, in my opinion, ultimately result in such a flood of selling that the Exchanges would have to be closed.

A great deal has been made of the cash positions of the funds. But I submit that the cash positions of the funds during a bear market is a tenuous thing. For instance, if a fund has $90 million in equity and $10 million in cash or equivalent it is supposed to be in a "conservative position" with a big reservoir of buying power. But suppose that $90 million in equity shrinks to a value of $50 million during a collapse? Do you think the fund is going to become wildly bullish because it has $10 million in cash. Actually, they're more likely to hang on to the $10 million and wish they have all $60 million in cash.

Assets (in millions)	Mutual Fund	% Change last 12 months	% change in 1969
BEST PERFORMERS			
$785.3	Nat'l Investors	— 0.76	+ 3.71
556.9	T. Rowe Price Gr	+ 0.12	+ 2.85
532	Chemical Fund	+ 0.09	+ 2.58
129.9	Johnson Mutual	— 2.25	+ 0.62
1,201	Mass Invstr Gr	— 2.51	+ 0.08
294.2	Putnam Investors	— 3.66	— 0.09
277.4	Windsor Fund	— 4.57	— 2.11
280.9	One William	— 6.13	— 2.94
391.4	Broad St. Inv.	— 6.52	— 3.72
157.2	Scudder I.S.C.	— 7.86	— 4.62
WORST PERFORMERS			
260.7	Axe-Houghton B	—23.86	—22.27
102.3	Competitive Capital	—24.81	—23.11
805.5	Enterprise	—24.13	—23.62
158.6	Channing Special	—25.92	—24.87
287.1	Channing Growth	—28.47	—25.43
315.4	American Investors	—28.87	—25.84
258.7	Value Line Spec.	—29.75	—29.06
186.4	Winfield Growth	—30.51	—29.11
118.7	Fletcher Capital	—29.78	—29.66
113:7	Putnam Equities	—34.82	—33.02
MARKET AVERAGES			
	Dow-Jones Indust.	—16.98	—14.12
	Standard & Poor's 500	—13.45	—10.20
	N.Y.S.E. Comp.	—14.37	—11.44

People forget that the fund managers are people like anyone else. They have emotions and they get scared just like you and I. It may take some time to prove my thesis, but in time I believe it will be proved. The funds could ultimately prove to be as much of a detriment in this bear market as they were a plus in the bull market. That's how I feel about them, anyway.



SUNDRY CHARTS AND COMMENTS:

The first chart shows the New York Times composite Average through the year 1969. Any way you look at it, 1969 was a year of almost unabated, drastic decline for stocks, and I thought this chart illustrated that fact dramatically.

Second, this clip from the Wall Street Journal indicates that 1969 was painful for Exchange members as well as the public. From the 1969 high of $515,000 for a seat, the latest seat sale has dropped to $270,000. Figuring that there were 1,366 seats of the N.Y.S.E., this adds up to a total paper loss of over $200,000 for Exchange members.

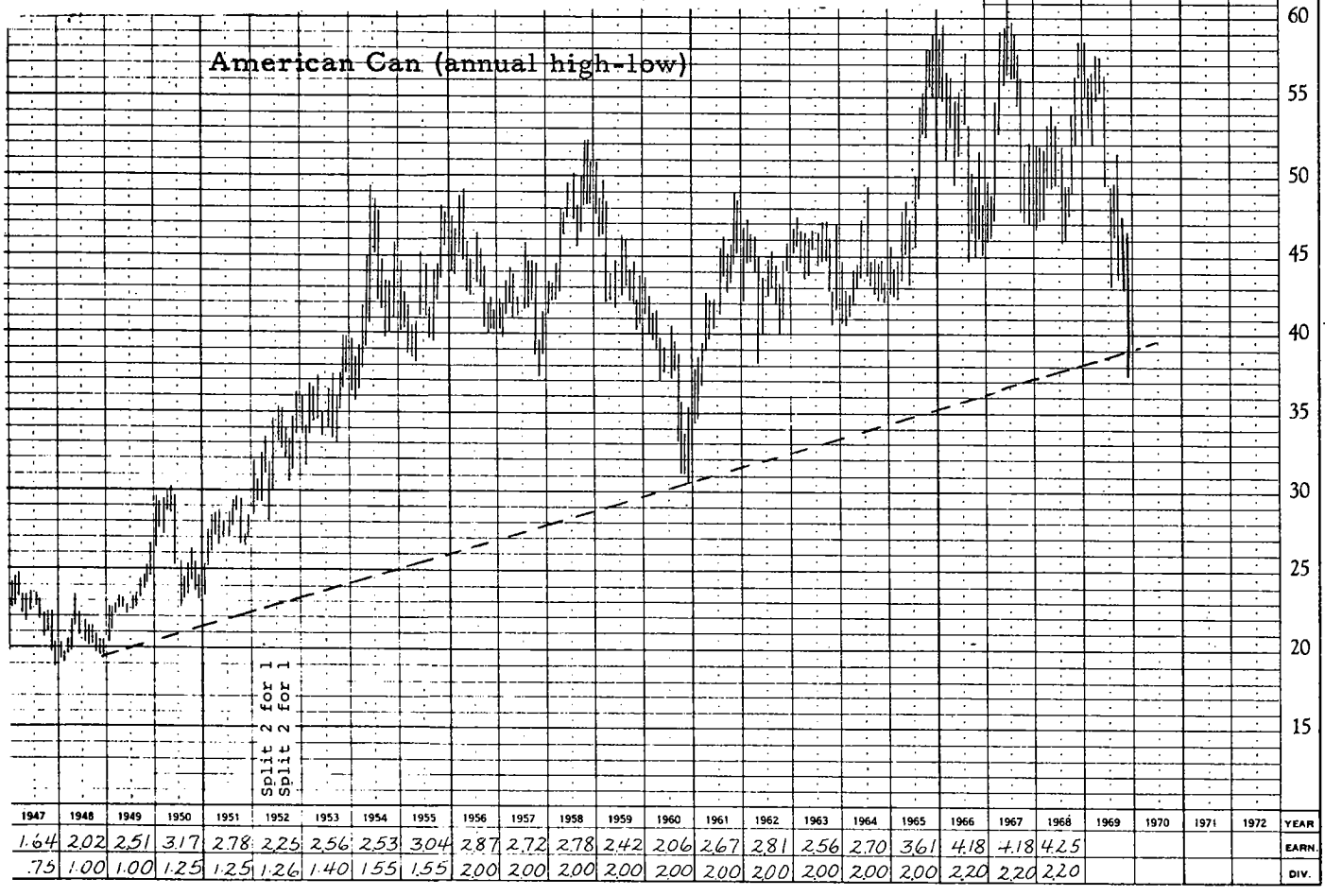
Big Board Seat Is Sold For $270,000, Off 48% From High Set This Year

By a WALL STREET JOURNAL *Staff Reporter*

NEW YORK—A membership on the New York Stock Exchange was sold yesterday for $270,000—off 48% from the record $515,000 at which such seats traded less than a year

STOCKS: One of the most shocking collapses (to me) has been the cave-in of blue-chip American Can. From a high of 64, recorded only two years ago in 1967, this stock plunged to last week's low of 37 1/2. That's a pretty wild slide from a "defensive-type" Dow stock. Here we see one of America's great corporations losing 42% of its total market value in a period of two years. Another way of putting it is that American Can rose from a 1948 bear market low of 19 to a 1967 all-time high of 64, a rise of 45 points. In the space of two years this stock has given up 56% of its gains of the past 21 years. That's how bear markets work. And that's why I like to get out of them. Chart courtesy of M.C. Horsey & Co.

Best wishes for 1970. Richard Russell



	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
YEAR																										
EARN.	1.64	2.02	2.51	3.17	2.78	2.25	2.56	2.53	3.04	2.87	2.72	2.78	2.42	2.06	2.67	2.81	2.56	2.70	3.61	4.18	4.18	4.25				
DIV.	.75	1.00	1.00	1.25	1.25	1.26	1.40	1.55	1.55	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.20	2.20	2.20				